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AUG 27 1992

Federal Communications Commission
Office of the Secretary

August 27, 1992

ORIGINAL FILE

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: <u>In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation</u>
CC Docket No. 92-135

Dear Ms. Searcy:

Please find enclosed for filing the original and eleven copies of the Organization for the Protection and Advancement of Small Telephone Companies' comments in the above-captioned proceeding.

Thank you for your assistance in this matter.

Sincerely,

Lisa M. Zaina

Lisa M. Zaina
General Counsel

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AUG 27 1992

Federal Communications Commission
Office of the Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Regulatory Reform for	)	
Local Exchange Carriers	)	CC Docket No. 92-135
Subject to Rate of Return	)	
Regulation	)	

COMMENTS OF THE ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COMPANIES

OPASTCO
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August 27, 1992

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SUMMARY

The Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO) believes in reducing regulatory burdens for small companies. In an effort to reduce regulatory burdens on small and mid-size local exchange carriers (LECs), the Commission suggests three alternatives that it believes will also bring them more efficiency and encourage technological development. These are: 1) an optional incentive plan for rate of return carriers that is an intermediate step on the road to price cap regulation; 2) expansion of the use of historical costs to compute common line rates; and 3) streamlining of the basic rate of return regulation that would apply to companies not electing any of the optional regulatory plans. It does not seem very likely that many OPASTCO members will adopt an incentive regulation plan, therefore it is crucial that the Commission recognize incentive regulation plans as options and not mandate them now or in the future. Small LECs need stability and reliability and therefore must have the option of maintaining rate of return regulation.

OPASTCO takes issue with the implication that small companies are inefficient, ineffectual and archaic because they are not on incentive regulation plans. Small companies have a history of providing high quality services to their customers and already have many incentives to invest in their networks. National Exchange Carrier Association (NECA) statistics clearly indicate that small and rural LECs are leaders in their field.

Many small rural LECs did not adopt price cap regulation because such a change could be a big risk for many of them. They face a very large risk as small companies doing business in an industry that is ever changing. The rate of return methodology has assured that these companies are able to provide the highest quality services to their customers at the most reasonable rates. Thus, the choice of rate of return as a viable mode of regulation must remain available to small rural LECs.

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COMMENTS OF
THE ORGANIZATION FOR THE PROTECTION AND
ADVANCEMENT OF SMALL TELEPHONE COMPANIES

I. INTRODUCTION

On July 17, 1992, the Federal Communications Commission (FCC or Commission) released its Notice of Proposed Rulemaking (NPRM) in the above-captioned proceeding.[1] The Commission is continuing its examination of regulatory methods for small and mid-size local exchange carriers (LECs) as it promised in its adoption of price caps for the largest LECs.[2]

The FCC intends that the proposed rules will complement the price cap system by providing incentives for the smaller

[1] In the Matter of Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket 92-135, Notice of Proposed Rulemaking (NPRM), released July 17, 1992. ("NPRM")

[2] Second Report and Order, 5 FCC Rcd 6786, 6827 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (Erratum by Com. Car. Bur.) (LEC Price Caps Order), modified on recon. 6 FCC Rcd 2637 (1991), further modified on recon. 6 FCC Rcd 4524 (1991) (ONA Part 69 Order), petitions for recon. of ONA Part 69 Order pending, appeal docketed, NRTA v. FCC, No. 91-1300 (D.C. Cir. June 26, 1991)

companies to become more efficient and by encouraging technological development. It suggests that because these companies primarily provide service to rural areas, the proposal will help bring benefits that are gained from incentive regulation to rural ratepayers. The Commission believes that the optimal solution for regulatory reform for these smaller companies is one which will allow the companies to pick the regulatory approach that best fits their needs and circumstances.

The Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO) represents a large number of the small LECs at which the FCC's proposal is directed. These companies and their customers have a big stake in the outcome of this proceeding. Thus, OPASTCO is very interested in the developments as they unfold. OPASTCO is a national trade association of more than 400 independently owned and operated telephone companies serving rural areas of the United States and Canada. The members, which include both commercial companies and cooperatives, range in size from less than 100 to nearly 50,000 access lines and together serve almost two million customers. OPASTCO has a few concerns about some of the assumptions made about small LECs and also has comments regarding several of the specifics of the Commission's proposal. OPASTCO hereby submits its comments in the above-captioned proceeding.

II. COMMENTS

A. Small Rural LECs Are Not Inefficient, Ineffectual and Archaic

OPASTCO believes that this proceeding may have a profound effect on its members. It is quite clear that the Commission favors a change in the current regulatory methodology employed by the small LECs. It seeks this change for the benefit of the ultimate customers of the small and mid-size LECs. It says that "The proposed rules are intended to complement the price cap system by providing incentives for smaller companies to become more efficient and by encouraging technological development".[3] However, in its quest for these changes and their intended results, the Commission implies that the small rural companies at which this proposal is directed are inefficient, ineffectual, and archaic. Quite the contrary is true. The small independent LECs have a proud history of serving their areas with the highest quality service at the most reasonable rates.

Generally, the quality of service in the small independent LECs' service areas is better than that in the rural areas of the larger LECs. One of the reasons that this is true is because the rural areas of the large LECs are not as profitable to serve as those companies' high density, high volume urban and suburban centers. Consequently they are more likely to make the business decision to put more of their investments into the urban markets, rather than the rural ones. In fact, during the open Commission

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[3]NPRM at para. 2, page 2.

meeting at which this proposal was adopted, Chief of the Common Carrier Bureau Cheryl Tritt lauded the service quality and technological innovations of the small rural LECs.[4] Yet, to read this NPRM, it appears that the Commission is proposing these regulatory alternatives as a fix for quality or technological problems in the exchanges served by the small and rural LECs.[5] If a small LEC were to adopt one of the proposed incentive plans it would not be because it was inefficient and in a technological time warp, but because it could make things better. It would do so because the regulatory approach better fits its needs and circumstances and those of its customers. Small LECs already have many incentives to invest in their networks.

When small and rural LECs invest in their networks they are investing in themselves, their neighbors, and their communities. According to National Exchange Carrier Association (NECA) statistics, in a study conducted in which the participants were 1000 small telephone companies that elect to participate in the NECA interstate access service tariff, 18% of the lines served by these companies were business. This compares to an industry

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[4]FCC Open meeting, June 18, 1992.

[5]NPRM at para. 1 page 2. The FCC seems to exhibit a bias against rate of return regulation. In discussing rate of return regulation in another proceeding, the Commission states: "The limitations and drawbacks of such 'cost plus' regulation include distorted incentives in capital investment, encouragement of cost-shifting when the carrier also participates in more competitive markets, and little incentive to introduce new and innovative services." In the Matter of Price Performance Review, Notice of Inquiry, CC Docket 92-134, released July 17, 1992 at para. 3, page 4. ("NOI")

average of 28%.[6] It is generally the residential customer that is the highest cost for the rural LECs to serve. Thus, rural LECs have the incentive to modernize their networks to provide high quality service to their neighbors and ensure that they attract business customers that will trigger rural economic development for their communities. Consequently, these companies have steadily converted to digital switching technology. By year-end 1992 it is expected that 93% of their central office switches will be digital.[7] In 1990, 76% of NECA companies' central offices were digital as compared to 59% of the Regional Bell Operating Companies' (RBOC) central offices. The NECA study also indicates that currently 30%, or almost 1700 offices have installed some fiber optic interoffice facilities.[8] Clearly, the small rural LECs are leaders in the industry, and are already doing some of the things that the Commission hopes to have them achieve by adopting an alternate form of regulation.

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[6] "MODERNIZING RURAL AMERICA --- Investments in new technologies by small telephone companies", National Exchange Carrier Association (NECA), 1992.

[7] Id. at page 8.

[8] Id. at page 14. These fiber optic interoffice facilities are those which interconnect central offices. NECA estimates that new fiber installations planned in 1992 will result in an additional five percent, or 300 central offices, being accessed through fiber facilities. Approximations indicate that by year-end 1994, 10 percent of the offices will have at least some fiber in their loop facilities. Because of volumes the interoffice trunk facilities have been capable of supporting fiber for some time. However, cost efficiencies of fiber in the loop facilities are just now beginning to materialize.

B. Price Caps Could Compound the Risks Faced by Rural LECs

The Commission remarks that the approximately 1300 carriers that remain under rate of return regulation have not adopted the price cap plan in part because "[T]hey appear to be adverse to the heightened risks inherent in a price cap system that requires prices to track a price cap over which the carrier has no control".[9] It is true that the rate of return methodology is one on which the small rural LECs can depend. Price caps do present an unknown risk to the small LECs. But it is an unknown that compounds another risk. This initial risk is the one of being a small business. It can be directly attributed to the fact that many small companies may face situations that require a huge outlay of funds and because of their size, such an outlay is not easily assimilated. Under price caps the small LEC may find it difficult to recoup these costs.

Rate of return regulation has ensured that the small rural LECs can bring better services to their customers. For instance, buying a new switch for an exchange, or upgrading software may be an insignificant investment for a large LEC, however it is a significant investment for a small LEC. Once such an investment is made, the small company's reserves may be depleted to such a point that it will be difficult to respond to urgent situations. That piece of equipment cannot necessarily be traded to rebuild the small LEC's network in the event of its destruction by a

[9] NPRM at paragraph 2.

natural catastrophe. Additionally, with the current emphasis on network reliability, small companies need to be able to continue to invest in upgrading their networks. Moreover, these small LECs need to keep reserves in order to attract capital. Rate of return methodology has assured that these companies are able to provide the best quality services to their customers at the most reasonable rates.

C. Proposed Alternatives Must Be Optional

Since the inception of the incentive regulation proceedings, OPASTCO has maintained that it would not oppose adoption of price caps if the incentive regulation were not made mandatory for its members. OPASTCO asserted that any regulatory reform proposal must be optional. The diversity of the small rural LECs is one of the main reasons that regulatory reform must be elective. As the FCC acknowledged: "[T]he size, diversity, and regulatory history of this group presents substantial challenges to designing incentive-based regulatory reforms."[10] Being forced to abandon a plan that has worked well for one that has no history and offers insecure footing in these changing times is ill-advised at best.

After review of the NPRM, OPASTCO understands the Commission is offering three proposals: 1) an optional incentive plan for rate of return carriers that is an intermediate step on the road to price cap regulation; 2) expansion of use of historical costs

[10] NPRM at paragraph 2.

to compute common line rates; and 3) streamlining of the basic rate of return regulation that would apply to companies not electing any of the optional regulatory plans. If the Commission had stopped here, OPASTCO would be convinced that the regulatory reform plans are ultimately optional. However, the Commission proceeded: *"The third part of our proposal, while representing a substantial improvement in the regulatory structure for the 1300 small and mid-sized carriers, is a first, and not a final step in long term regulatory reform for these companies."*[11] Thus, it appears that endorsing these proposals may mean ultimately endorsing mandatory incentive regulation for OPASTCO members. OPASTCO supports reform for its members that will reduce their regulatory burdens. OPASTCO cannot support compulsory adoption of incentive regulation and forced abandonment of rate of return regulation. Before OPASTCO can consider endorsing these incentive regulation for small LECs, it would like clarification from the FCC that today's optional plans will not metamorphose into tomorrow's mandatory plans.[12]

D. OPASTCO Supports Reducing Burdens for Small LECs

OPASTCO is a staunch supporter of reducing regulatory burdens on small rural LECs. Many efficiencies could be realized

[11]NPRM at paragraph 4. (emphasis added)

[12] It is true that the Commission in paragraph 22 of the NPRM states: "We tentatively conclude that any incentive plan designed for rate of return carriers should be optional". However, because of some of the incompatible statements, OPASTCO is not completely convinced that the Commission will not eventually authorize incentive regulation.

if the small LECs were permitted to reduce their administrative burdens and concentrate on providing new and better services to their customers.

There are a few ways in which to reduce the regulatory burdens on small LECs. One manner in which to reduce the regulatory burdens of the small LECs is to expand historical costs to compute common line rates. OPASTCO has been a strong supporter of applying the Section 61.39[13] rules that apply to traffic sensitive rates for carriers under 50,000 access lines to the common line rates. Another way would be to permit small exchange carriers to elect average schedule status and not limit the average schedule methods to only those telephone companies that were "participating in average schedule settlements on December 1, 1982."[14] These are two ways to lessen the regulatory burdens on small LECs.

One additional, unwarranted administrative burden is the one associated with mergers and acquisitions. The FCC proposes a general rule that if an incentive plan carrier acquires a non-incentive plan carrier it must convert the latter to the incentive regulation plan. Additionally, the Commission attempts to accomodate small company concerns by proposing that when a small, baseline-regulated carrier acquires a few exchanges from an incentive-regulated carrier the small carrier must petition

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[13] 47 C.F.R. Section 61.39.

[14] 47 C.F.R. Section 69.605

the Commission in order to merge the affected study areas.[15] However, this accomodation still creates burdensome requirements for the small LECs because it places the onus on them to prove why they should be able to merge the study areas. OPASTCO believes that if a small non-incentive LEC acquires an incentive plan exchange that it should be able to merge without petitioning the FCC unless the FCC shows why such a merger is against the public interest.

III. CONCLUSION

OPASTCO supports reduced regulation for its members. Reducing the regulatory burden on these small carriers will allow them to devote more time to what is most important -- their customers. However, reduced regulation does not necessarily mean changing the basics of regulation. Consequently, OPASTCO believes that the incentive-based regulatory reform proposals must be optional for the small LECs. Small LECs need stability and reliability and thus must have the option of maintaining rate of return regulation. Without this stability the small LECs will not be able to plan for anything in this rapidly changing environment.

The incentive regulation plans may work for some of those companies that did not choose to adopt price cap regulation, but not for all of them. Small LECs face greater risks due to their

[15] NPRM at para. 50, page 17.

size and the changing environments. Moreover, small LECs need capital to continue to make the advances that they have made and one attracts capital by being stable and reliable and not a high risk venture. Consequently, OPASTCO believes that many of its members will want to remain on rate of return, and will not adopt an incentive plan. Therefore, these plans must truly be optional.

Respectfully submitted,

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General Counsel

The Organization for the
Protection and Advancement of
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August 27, 1992

CERTIFICATE OF SERVICE

I, Matthew L. Dosch, hereby certify that a copy of OPASTCO's comments was sent on this, the 27th day of August, 1992, by first class United States mail, postage prepaid, to those listed below.

Matthew L. Dosch

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